

# REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON UBUNTU LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the accompanying financial statements of the Ubuntu Local Municipality, which comprise the statement of financial position as at 30 June 2011, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages XX to XX.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practise (SA Standards of GRAP) the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No 56 of 2003) (MFMA) and Division of Revenue Act South Africa, 2010 (Act No.1 of 2010 as amended) (DoRA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Because of the matters described in the basis for disclaimer of opinion paragraphs, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for disclaimer of opinion

#### Revenue

4. The completeness, accuracy, occurrence and classification of the prior year revenue from non-exchange transactions disclosed as R4 142 385 in the statement of financial performance could not be confirmed as there was a difference of R102 076 614 between the value of the properties in the valuation roll, R2 737 751 314 and the amount recorded in the financial system, R2 635 674 700. The lack of documentation at the municipality did not enable me to determine the extent of the error or to perform feasible alternative procedure.
5. The completeness of revenue from exchange transactions (service charges and other income) of R12 336 839 as disclosed in the statement of financial performance could not be confirmed as:
  - (a) Certain water meters were identified that did not reflect on the meter reading listing and consumption was consequently not levied.
  - (b) Management did not implement controls over rental of grazing property such as revenue registers, invoices, monthly reconciliations and monthly certificates indicating the quantities live stock that was held during the year.

The lack of supporting documentation did not permit the application of alternative procedure or to determine the total extent of the misstatement.

6. Paragraph 46 of the SA Standards of GRAP 23 states that revenue from a non-exchange transaction shall be measured at the amount of the increase in net assets recognised by the entity.
  - (a) Differences were found between the rates tariffs charged and the rates tariffs that were approved by council. Revenue from non-exchange transactions and receivables from non-exchange transaction are understated with an amount of R542 996 respectively.
  - (b) Certain properties were identified for which rates were not charged against the consumer accounts. Revenue from non-exchange transactions and receivables from non-exchange transactions are understated with R1 422 154 respectively.
7. Paragraph 15 of the SA Standards of GRAP 9, revenue from exchange transactions, states that revenue shall be measured at the fair value of the consideration received or receivable. Contrary to these requirements it was identified that subsidies granted to indigents exceeded the maximum amount as determined by council. Revenue from exchange transactions and the provision for bad debt adjustment are understated with R448 236 respectively.

#### **Property, plant and equipment**

8. I was unable to obtain sufficient appropriate audit evidence to conclude on the completeness, existence and valuation of and the rights to ownership of property, plant and equipment of R117 503 235 (2010: R116 657 574), as disclosed in note 12 to the financial statements, due to the following:
  - (a) Certain physically identified land and buildings and other assets could not be traced to the fixed asset register due to buildings not being included in the asset register. Un-bar-coded movable assets, identified during physical verification, could not be located on the fixed asset register. Municipal properties as per the valuation roll could not be traced to the fixed asset register. The amount could not be quantified owing to the asset register not being complete.
  - (b) The assumptions used by the expert regarding the size of certain property and the rate per square meter used to value the property of R2 572 960 (2010: R2 587 460) could not be submitted.
  - (c) Sufficient appropriate audit evidence regarding the value of infrastructure assets of R1 033 798 were not submitted.
  - (d) Property, plant and equipment of R1 686 498 could not be verified due to unique identifying markers not being allocated to assets and the correct global positioning co-ordinates not being included in the fixed asset register.
  - (e) A property that is held for social services could not be traced to the asset register. I was not able to determine the amount of the limitation.

The municipality's records did not permit the successful application of alternative procedures.

#### **Investment property**

9. I was unable to obtain sufficient appropriate audit evidence to conclude on the completeness, existence and valuation of and the rights to ownership of investment property of R15 906 693, as disclosed in note 13 to the financial statements, due to the following:

- (a) The assumptions used by the expert regarding the size of the property and the rate per square meter used to value the property of R1 587 958 (2010: R1 603 458) could not be obtained.
- (b) Property included as Erf 1 was not completely unbundled. Certain properties that are leased to lessees were not individually captured onto the investment property register. I was not able to determine the impact of the limitation.
- (c) Grazing property that are leased for agricultural purposes could not be traced to the asset register. I was not able to determine the amount of the limitation.

The municipality's records did not permit the successful application of alternative procedures.

### **Receivables**

10. The existence and valuation of long term receivables, receivables from exchange and non-exchange transactions of R2 183 359 (2010: R2 403 833) as disclosed in note 20 and 21 in the notes to the financial statements could not be confirmed as:

- (a) Sufficient appropriate audit evidence was not available to support management assumptions regarding the provision for bad debt of R6 886 302 (2010: R8 384 103).
- (b) Consumer receivables from exchange and non-exchange transactions of R315 523 could not be supported with sufficient appropriate audit evidence.

The municipality's records did not permit the successful application of alternative procedures.

### **Expenditure**

11. The occurrence and accuracy of expenditure of R1 472 527 included in the operating expenditure disclosed as R33 324 513 in the statement of financial performance, could not be confirmed, as it was not supported by sufficient appropriate audit evidence. Owing to the lack of supporting documentation there were no alternative procedures that could be performed to verify the reported expenditure.
12. Paragraph 6 of the SA Standards of GRAP 1, presentation of financial statements, states that expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence's of liabilities that result in decreases in net assets, other than those relating to distributions to owners:

Unmatched fines revenue was not included in the calculation of contracted services. The amounts were however recognised as revenue and therefore the commission thereon should be included in the same accounting period. Consequently, contracted services is understated with R736 953, VAT (contracted services) is understated with R103 173 and payables are understated with R840 127.

### **Inventory**

13. The completeness, rights and obligations, existence and valuation of inventory in the prior year of R366 944 as disclosed in note 19 of the financial statements could not be confirmed due to a proper system together with supporting documentation to record the receipt and issue of inventory not being maintained during the prior year. In addition sufficient evidence that a year-end inventory count had been performed could not be submitted for audit purposes. Evidence could not be obtained that regular inventory counts and internal checking by management had been performed. The system did not permit the performance of alternative procedures.

### **Employee benefits**

14. Paragraph 6 of the SA Standards of GRAP 1 states that liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential. The liability regarding staff leave as included in note 7 to the financial statements is overstated by R298 763, employee cost is overstated by R326 297 and receivables are understated by R27 534. The differences identified were due to leave per leave forms that was not accurately captured onto the system as well as the leave not forfeited after 48 days.

### **Provisions**

15. The valuation of non-current provisions and provisions of R1 471 050 (2010: R1 382 245) according to the statement of financial position could not be confirmed as sufficient, appropriate audit evidence could not be obtained to confirm the assumptions made regarding the provision for rehabilitation of the landfill sites. Alternative procedures that included obtaining cost values from external parties as well as comparison to costs used by similar municipalities could not provide sufficient evidence to confirm the assumptions made by management.

### **Irregular expenditure**

16. The completeness of irregular expenditure of R10 550 539 (2010: R5 167 318) as disclosed in note 45.3 to the financial statements could not be determined as:

- There were insufficient controls to ensure that all irregular expenditure is identified, investigated and recorded.
- The limitation imposed by the lack of supporting documentation for the procurement of assets and expenditure did not enable me to determine whether all irregular expenditure was identified.
- Undisclosed irregular expenditure of R2 592 088 (2010: R680 735) was identified, which resulted from non-compliance with the municipality's supply chain management policy.

There were no satisfactory alternative audit procedures that I could perform to mitigate this risk.

### **Distribution losses**

17. The occurrence, completeness and accuracy of water distribution losses of R850 394 as disclosed in note 45.4 could not be confirmed as sufficient appropriate audit evidence such as water consumption from the reservoirs not being available. Section 125 (d) of the MFMA states that the notes to the annual financial statements of a municipality must disclose the particulars of any material losses. Due to the limitations imposed by the system, the total extent and consequent impact of this could not be determined and alternative procedures could not be performed.

### **Disclaimer of opinion**

18. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

**Emphasis of matters**

19. I draw attention to the matters below. My opinion is not modified in respect of these matters:

**Financial sustainability**

20. Note 55 to the financial statements indicates the following conditions that indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to operate as a going concern:

- The current ratio decreased to 0.49:1 from 0.87:1 in the prior year
- The municipality have budgeted for a deficit of R7 180 000 for the 2011-12 financial year. The municipality is also budgeting for negative cash flows during 2012-13 and 2013-14 of R3 068 000 and R22 056 000 respectively.
- The average debtors' payment days increased to 478 days from 460 days. The debtors' impairment ratio increased to 91% from the previous year's 88%.
- A bank overdraft facility is utilised of R1 400 000.
- The municipality is in arrears with the prepayment of loans with the Development Bank of South Africa to an amount of R 648 837 (2010 - R572 745)
- A possible outflow of resources could occur due the contingent liability disclosed in note 53.

**Unauthorised expenditure**

21. As disclosed in note 45.1 to the financial statements, unauthorised expenditure of R29 567 633 (2010: R6 281 701) was incurred due to the overspending of the individual votes.

**Restatement of corresponding figures**

22. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during 30 June 2011 in the financial statements of Ubuntu local municipality at, and for the year ended, 30 June 2011 of R14 511 201.

**Material losses**

23. As per disclosure note number 44.4 the municipality incurred electricity distribution losses of R12 490 045 (2010: R11,116,861) during the financial period under review. No reasons have been provided for the abovementioned losses being incurred as required by section 125 (2) (d) (iii) of the MFMA.

**Material underspending of budget**

24. As disclosed in note 44 to the financial statements, a material under spending of voted funds occurred of R4 509 857. Due to the annual report not being submitted for audit purposes, the effect on service delivery by the Municipality could not be determined.

**Fruitless and wasteful expenditure**

25. As disclosed in note 45.2 to the financial statements, fruitless and wasteful expenditure of R989 162 (2010: R594 318) was incurred due to interest incurred on the exceeding of payment terms and arrear payments.

### **Additional matters**

26. I draw attention to the matter below. My opinion is not modified in respect of this matter:

### **Unaudited supplementary schedules**

27. The supplementary information set out on pages ~~XX~~ to ~~XX~~ does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

### **Material inconsistencies in other information included in the annual report**

28. The annual report has not been received at the date of this report; as a result, a conclusion could not be drawn on the consistency between the financial statements and the audit report with other information included in the annual report.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

29. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette No. 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ~~XX~~ to ~~XX~~ and material non-compliance with laws and regulations applicable to the municipality.

### **Predetermined objectives**

30. I was unable to conduct the audit of performance against predetermined objectives as the municipality did not submit the annual performance report as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No.32 of 2000) (MSA) and section 121(3)(c) of the MFMA.

### **Compliance with laws and regulations**

#### **Strategic planning and performance management**

31. The municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players contrary to the requirements of section 38, 39, 40 and 41 of the MSA read with regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

32. The quarterly reports on the progress in achieving measurable objectives and targets were not prepared, contrary to section 36.

33. Senior managers directly accountable to the municipal manager did not sign annual performance agreements for the year under review, contrary to the requirements of sections 57(1)(b) and 57(2)(a) of the MSA. Performance bonuses were paid in certain instances.

34. The municipal manager did not sign an annual performance agreement for the year under review, contrary to the requirements of sections 57(1)(b) and 57(2)(a) of the MSA. A performance bonus was paid to the municipal manager.

35. The annual performance report could not be obtained, consequently I was not able to confirm whether the annual performance report contain a comparison of the performance of the municipality and of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan contrary to the requirements of section 46 of the MSA.

36. The performance report for the financial year under review was not prepared contrary to the requirements of section 46 of the MSA read with section 121(3)(c) of the MFMA
37. The IDP of the municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by section 26(i) and 41(1)(b) of the MSA.
38. The municipality did not set performance targets on an annual basis, as required by section 41(1)(a) of the MSA.

#### **Budget**

39. The municipality incurred expenditure that was not budgeted for and incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.
40. The mayor did not submit all quarterly reports to council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, contrary to the requirements of section 52(d) of the MFMA.
41. The accounting officer did not always submit the monthly budget statements to the mayor and the relevant provincial treasury, contrary to the requirements of section 71(1) of the MFMA.
42. Unforeseeable and/or unavoidable expenditure not provided for in the annual budget was incurred but was then not appropriated in an adjustment budget, contrary to the requirements of section 29(2)(d) of the MFMA.

#### **Financial statements and annual performance report**

43. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of capital assets, current assets, current liabilities, revenue, expenditure and disclosure items identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a disclaimer audit opinion.
44. The performance report for the financial year under review was not prepared contrary to the requirements of section 46 of the MSA read with section 121(3)(c) of the MFMA.
45. The accounting officer did not prepare and include an assessment of the performance against any measurable performance objectives set, in terms of the service delivery agreement contrary to the requirements of section 46 of the MSA read with section 121(4)(d) of the MFMA.

#### **Audit committees**

46. The audit committee did not function contrary to the requirements of section 166 of the MFMA, in that:
  - The audit committee did not advise the council, the accounting officer and the management staff of the municipality on matters relating to internal financial control and internal audits, risk management, accounting policies, performance management, effective governance, compliance with applicable legislation and performance evaluation.
  - The audit committee did not review the annual financial statements.
  - The audit committee did not respond to the council on any issues raised by the Auditor-General in the audit report.

47. The audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information contrary to the requirements of section 166(2)(a)(iv) of the MFMA.
48. The audit committee did not advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality on matters relating to compliance with the MFMA, the DoRA and other applicable legislation contrary to the requirements of section 166(2)(a) of the MFMA.
49. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee contrary to the requirements of regulation 14(2)(a) of the Municipal Planning and Performance Management Regulations, 2001.

#### **Procurement and contract management**

50. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) and (c).
51. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of between R10 000 and R200 000 were procured by means of obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) and (c).
52. Quotations were accepted from prospective providers who are not on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
53. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
54. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
55. Sufficient appropriate audit evidence could not be obtained that awards were to providers based on criteria that were similar to those stipulated in the original bid documents or were stipulated in the original bid documents as per the requirements of SCM regulation 21(b) and 28(1).
56. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days as per the requirements of SCM regulation 22(1) and 22(2).
57. Sufficient appropriate audit evidence could not be obtained that final awards and/or recommendation of awards to the accounting officer were made by an adjudication committee constituted as per the requirements of SCM regulation 29(2).
58. Awards were made to providers whose tax matters had not been declared by the South African Revenue Services to be in order contrary to the requirements of SCM regulation 43.
59. Sufficient appropriate audit evidence could not be obtained that awards were made to providers whose tax matters have been declared by the South African Revenue Services to be in order contrary to the requirements of SCM regulation 43.



60. The preference point system was not applied in all procurement of goods and services above R30 000 contrary to the requirements of section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
61. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 contrary to the requirements of section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
62. Awards were made to suppliers based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
63. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
64. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers that scored the highest points in the evaluation process as per the requirements of section 2(1)(f) of Preferential Procurement Policy Framework Act.
65. The service providers failed to declare that they were in the service of the state contrary to the requirements of SCM regulation 13(c).
66. A list of accredited prospective providers was not in place for procuring goods and services through quotations contrary to the requirements of SCM regulation 14(1)(a).
67. It was identified that the items management identified as irregular expenditure were not reported to council, contrary to the requirements of regulation 36 subparagraph (2) of the supply chain management regulations.

#### **Expenditure management**

68. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, contrary to the requirements of section 65(2)(e) of the MFMA.
69. Sufficient appropriate audit evidence could not be obtained that money owing by the municipality was always paid within 30 days of receiving an invoice or statement, contrary to the requirements of section 65(2)(e) of the MFMA.
70. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, contrary to the requirements of section 32(2) of the MFMA.
71. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, contrary to the requirements of section 62(1)(d) of the MFMA.
72. The accounting officer of the municipality did not inform the MEC of local government in the province and the Auditor General in writing of any unauthorised, irregular or fruitless and wasteful expenditure incurred by the municipality and whether any person responsible is under investigation for such unauthorised, irregular or fruitless and wasteful expenditure as disclosed in the note 44.3 to the financial statements, contrary to the requirements of section 32(4) of the MFMA.

#### **Revenue management**

73. A credit control and debt collection policy was not implemented contrary to the requirements of section 96(b) of the MSA.

74. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised revenue when it is earned and accounted for debtors, contrary to the requirements of section 64(2)(e) of the MFMA.

#### **Asset management**

75. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality contrary to the requirements of section 63(2)(a) of the MFMA.
76. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets contrary to the requirements of section 63(2)(c) of the MFMA.

#### **INTERNAL CONTROL**

77. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

78. The following challenges were experienced that contributed to the weaknesses in the financial environment and the ultimate audit outcome:
- Personnel had not been allocated specific duties and responsibilities to facilitate the continuous monitoring of internal controls.
  - The leadership did not take appropriate action with regard to a lack of controls in the finance and supply chain management directorates, resulting in non-compliance with applicable legislation and inadequate budget control measures. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure.
79. Leadership did not regularly monitor management's compliance with laws, regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted.

#### **Financial and performance management**

80. The municipality did not have individuals who sufficiently understand the financial reporting framework and performance and financial management requirements. This resulted in the municipality engaging a consultant to prepare the financial statements. The underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework.
81. The post of chief financial officer was vacant for a major part of the financial year. Consequently, the municipality did not have mechanisms in place to sufficiently monitor the recording and reconciliation of the financial records.
82. Manual or automated controls were not designed to ensure that the transactions had occurred, were authorised, and were completely and accurately processed. Documentation supporting amounts disclosed in the financial statements was not always available.

83. Management did not document and approve internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting on performance information. Consequently, performance systems, processes and procedures had not been designed and implemented.

#### **Governance**

84. The risk of material misstatement due to fraud was not considered. Sufficient controls and segregation of duties to prevent or detect fraudulent data and asset misappropriation were not implemented and maintained.

85. The municipality did not respond to the assessed risks by determining a risk strategy and action plan to manage identified risks. Consequently, internal controls were not selected and developed to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

86. The financial statements were subject to material corrections resulting from the audit, which are attributable to the lack of risk assessment performed, weaknesses in the design and implementation of internal control in respect of financial management, and financial reporting and weaknesses in the information systems.

87. The accounting officer did not prioritise the establishment of a fully functioning performance audit committee and audit committee and therefore the functions were not established and functional during the financial year. This also resulted in the committees not being able to fulfil all their responsibilities.

*Auditor - General*  
Kimberley

30 November 2011



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*